

Emerging Economies Group
May 2020
Agenda Paper 7

Management Commentary

Introduction to the forthcoming Exposure Draft

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or the IFRS Foundation.

Objective of the session and agenda



This session will cover:

- Overview of the Management Commentary project (slides 3–10)
- Basis of preparation and disclosure objectives (slides 11–15)
- Main areas of content (slides 16–26)

Note: Appendix A includes a summary of the Board's tentative decisions to date and Appendix B includes possible supporting guidance for the main areas of content in management commentary



- Presentation by IASB Technical Staff (30 minutes)
- Questions from EEG members (30 minutes)



Overview of the Management Commentary project

Further details can also be found at
<https://www.ifrs.org/projects/work-plan/management-commentary/>

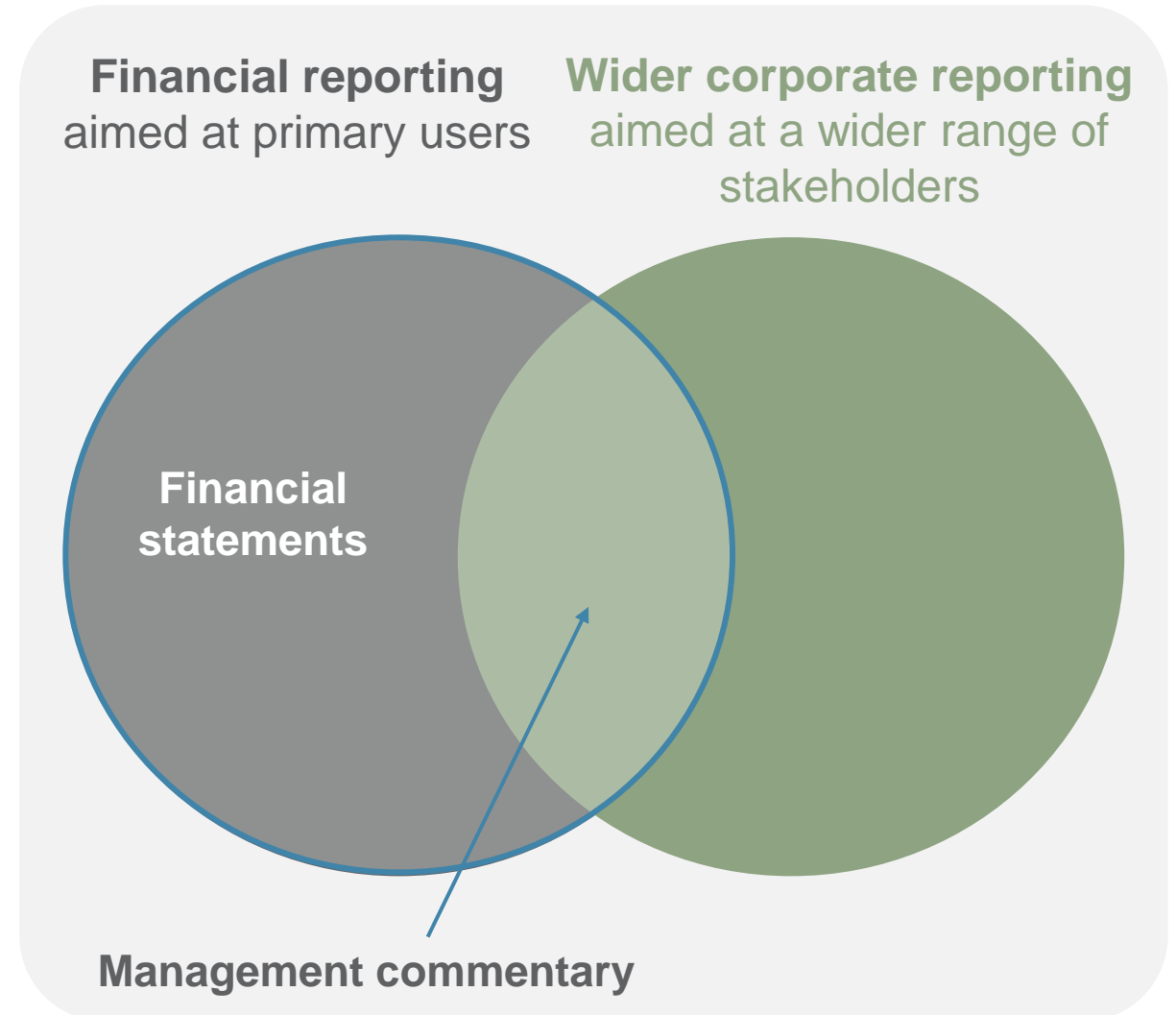
Timeline



What is management commentary?

- A narrative report that gives context for the financial statements and additional insight into the company's long-term prospects
- Sits within the boundaries of financial reporting and is aimed at the company's existing and potential investors, lenders and other creditors*

Information about environmental, social and governance matters—normally part of wider corporate reporting—is provided in management commentary if a matter could affect the entity's ability to create value for itself and to generate cash flows, including over the long term.



*The *Conceptual Framework* identifies investors, lenders and other creditors as the primary users of financial reports

Management commentary reports around the world



Why revise?

Developments in narrative reporting



Gaps in current reporting practice



Increasing need for additional information



Focus of revision

Align with primary users' changing information needs

Retain a principles-based approach but expand the guidance to:

- consolidate innovations
- address gaps in reporting
- support rigorous application

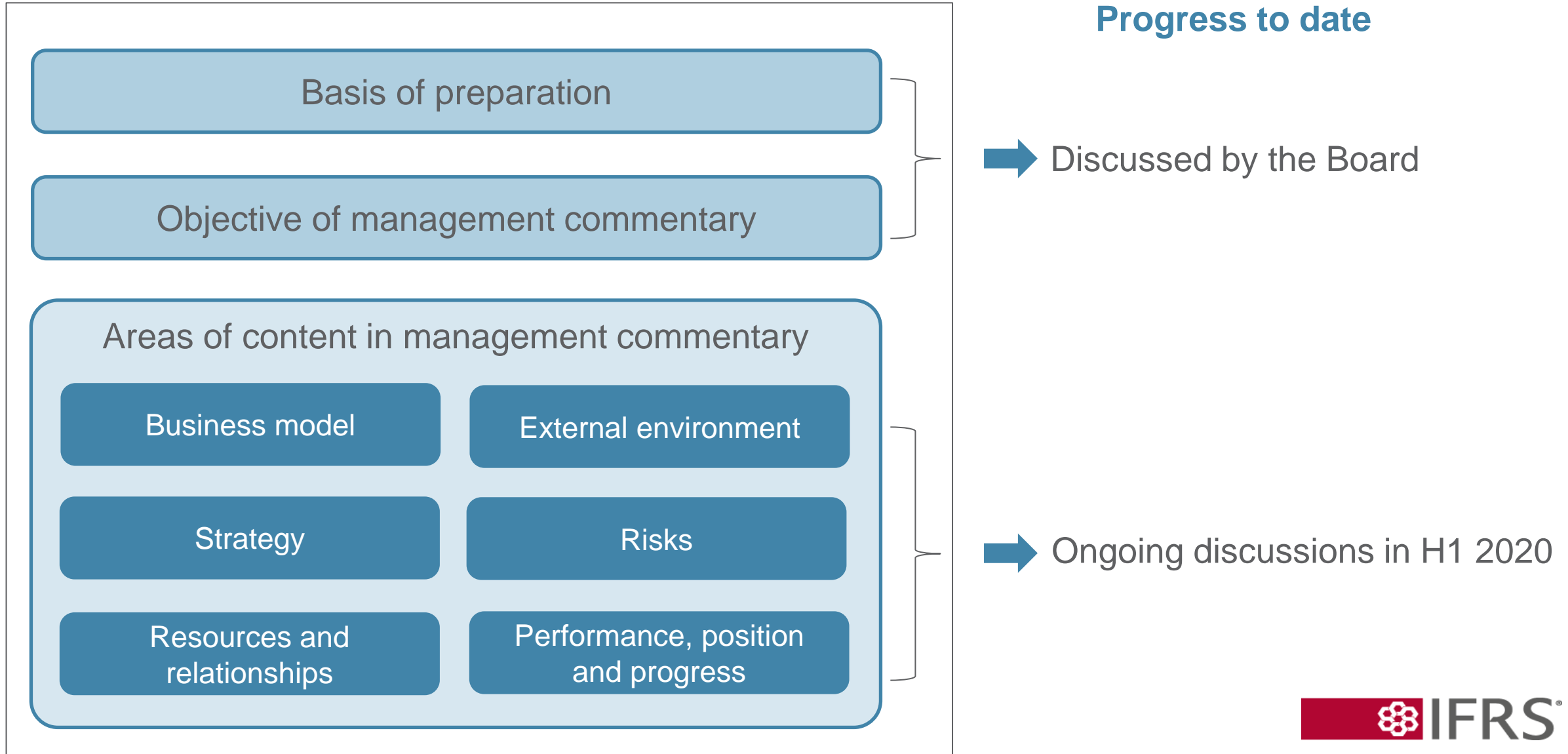
Particular emphasis on:

- company-specific matters
- intangibles and ESG* matters if information is material
- matters that underpin ability to create value and generate cash flows
- linkage across areas of content and with financial statements

Aim to be compatible with jurisdictional requirements and subject-matter frameworks (eg TCFD, SASB)

* ESG is used to refer to environmental, social or governance matters

Revision of the existing Practice Statement




Cross-cutting considerations (1/2)

Topic	Staff's approach
Compliance	<ul style="list-style-type: none">The Practice Statement is not a Standard. However, some entities might be required to prepare management commentary applying the Practice Statement and other entities might choose to do so. Entities that are required or choose to apply the Practice Statement and assert compliance with it, would be expected to comply with all applicable aspects of the Practice Statement.
Principles-based approach	<ul style="list-style-type: none">The revised Practice Statement will retain a principles-based approach as management commentary must be specific to an entity's circumstances but will provide guidance to help management identify information that needs to be included. The structure of the revised Practice Statement is not intended to prescribe the structure of management commentaries.
IFRS Taxonomy	<ul style="list-style-type: none">The staff intend for the revised Practice Statement to be compatible with IFRS Taxonomy and result in information in management commentaries that can be tagged using IFRS Taxonomy.

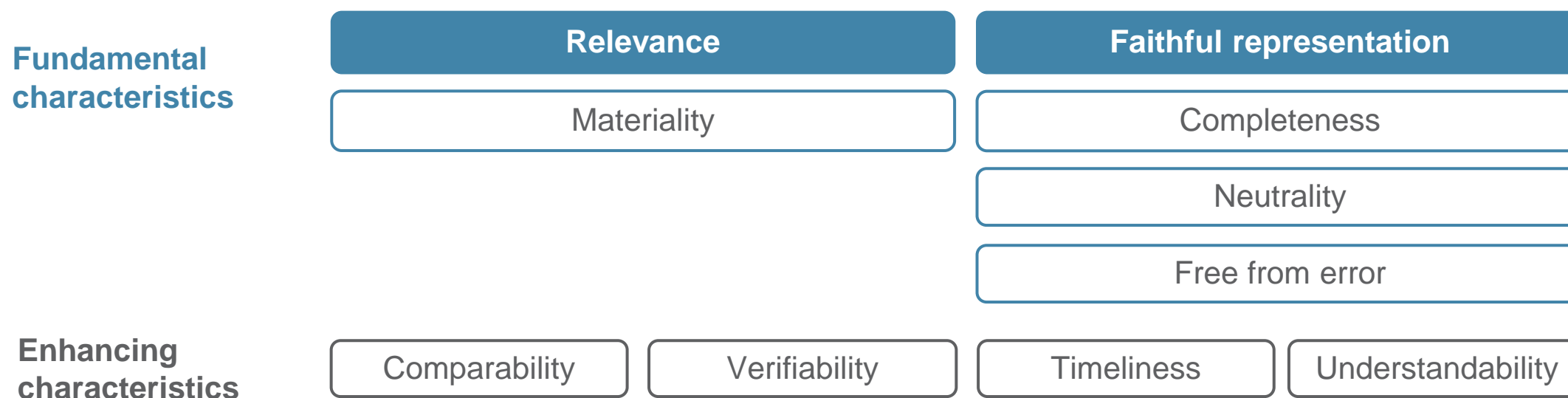
Cross-cutting considerations (2/2)

Topic	Staff's approach
ESG matters	<ul style="list-style-type: none">The staff do not expect that the revised Practice Statement will include specific guidance on reporting ESG matters. However, guidance across various areas of content will address material information about environmental, social and governance matters.
Intangibles	<ul style="list-style-type: none">The staff do not plan to include a separate section on reporting intangibles in the revised Practice Statement. However, intangibles will be addressed in the section on resources and relationships.
Long-term	<ul style="list-style-type: none">Matters that can affect the entity in the long term will be addressed across various areas of content. For example, the Board tentatively decided that in discussing strategy management should explain the entity's long-term objectives.



Basis of preparation and disclosure objectives

- The Board tentatively confirmed the qualitative characteristics of useful information in management commentary as set out in the *Conceptual Framework*. These are:



- The Board tentatively decided to provide guidance on how to consider those characteristics in preparing management commentary, in particular on how to make materiality judgments.

The Board's tentative decisions on qualitative characteristics are set out on slides 28–30.

The objective of management commentary

- Both financial statements and management commentary are intended to help investors and creditors:

Assess prospects for future **cash flows**

Assess management's **stewardship**

- The Board tentatively decided to clarify how the objective of management commentary differs from the objective of financial statements.

Objective of financial statements

Provide useful **financial information about** the reporting entity's **assets, liabilities, equity, income and expenses**

Objective of management commentary

Provide **useful information and analysis to:**

Enhance investors' understanding of the entity's performance and position as depicted in the related financial statements

Give insight into factors that could affect the entity's **prospects**

Introducing disclosure objectives

- The existing Practice Statement does not include explicit disclosure objectives for the main areas of content in management commentary.

Disclosure objectives for the main areas of content

Are designed to:

- support all the dimensions of the overall objective of management commentary
- provide a link between the overall objective of management commentary and the supporting guidance

Are intended to help:

- preparers to identify what information to provide in management commentary
- regulators and assurers to assess whether management commentary meets its overall objective

- To fulfil that role, disclosure objectives must be based on clear principles, focus on investors and creditors' information needs and contain sufficient amount of detail.

Design of disclosure objectives

Headline objective

Sets out the main principle for the area of content

Assessments

Describes the assessments that investors and creditors typically make in relation to the area of content

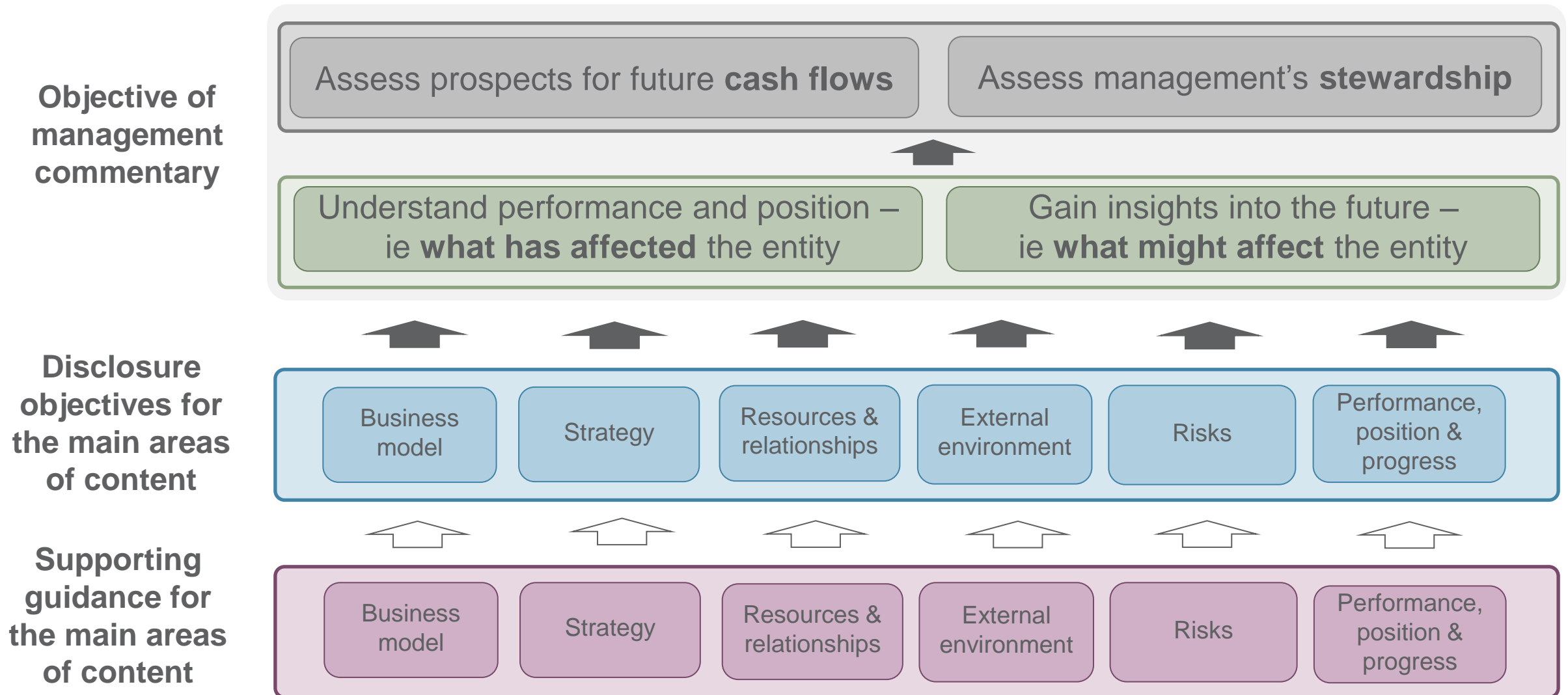
Information and analysis

Describes the types of information and analysis that need to be provided and requires a focus on key matters in providing that information



Main areas of content

Disclosure objectives and supporting guidance



Business model (1/2)

The Board's tentative decisions:

Headline objective	Provide information and analysis to help investors and creditors understand how an entity's business model creates value and generates cash flows
Assessments	Investors and creditors assess: <ul style="list-style-type: none">• how effective the entity's business model is in creating value and generating cash flows• how scalable it is• how resilient, adaptable and durable it is
Information and analysis	Key features of the business model, addressing: <ul style="list-style-type: none">• the range, nature and scale of the entity's operations• the entity's cycle for creating value and generating cash flows• the impacts of the entity's operations that could affect the entity's ability to create value and generate cash flows

Key features	Features that underpin the entity's ability to create value and generate cash flows
Examples	<ul style="list-style-type: none">• Features that underpin the entity's value proposition (eg a product that meets a specific need of a particular consumer category)• Features that provide the entity with a competitive advantage (eg know-how in a particular area)• Features that create uncertainty about the entity's ability to create value and generate cash flows (eg uncertainty over receiving a patent on a major new product developed by the entity)• Features that need to change or changed in the reporting period and affect the entity's ability to create value and generate cash flows (eg a process that needs to be changed to comply with new environmental regulations or a new product expected to generate significant revenue in the future)

 Possible supporting guidance on business model is set out on slide 37

The Board's tentative decisions:

Headline objective	Provide information and analysis to help investors and creditors understand management's strategy for sustaining and developing the entity's ability to create value and generate cash flows in the future
Assessments	Investors and creditors assess: <ul style="list-style-type: none">• the potential effect of strategy on the entity's ability to create value and generate cash flows• the entity's ability to execute the strategy
Information and analysis	Key aspects of management's strategy, addressing: <ul style="list-style-type: none">• what drives the strategy• what management aims to achieve in the long term• how management plans to achieve those aims• how management will monitor and measure success

Key aspects	Aspects of strategy that will significantly affect an entity's ability to create value and generate cash flows in the future
Examples	<ul style="list-style-type: none">• Important long-term objectives that explain how management intends to sustain and develop the entity's ability to create value and generate cash flows (for example, how the entity intends to create a significant competitive advantage or seize a particular opportunity)• Important milestones towards achieving the long-term objectives• Important plans that reflect priorities for action and help measure progress towards achieving the milestones and objectives• Allocation of resources, in particular financial resources, to support execution of the long-term objectives• A system of incentives to support execution of long-term objectives

 Possible supporting guidance on strategy is set out on slide 38

Resources and relationships (1/2)

The Board's tentative decisions:

Headline objective	Provide information and analysis to help investors and creditors understand the resources and relationships on which the business model and strategy depend
Assessments	Investors and creditors assess: <ul style="list-style-type: none">• how much the entity depends on particular resources or relationships;• whether those resources are likely to continue to be available to the entity and whether the entity's relationships are likely to continue and grow
Information and analysis	Key resources and relationships, addressing: <ul style="list-style-type: none">• the nature of the entity's resources and relationships• how those resources and relationships are accessed• how they are used• what could affect the availability of the entity's resources and the strength of its relationships• how those resources and relationships are managed

Resources and relationships (2/2)

Key resources & relationships	Resources and relationships on which the entity's ability to create value and generate cash flows depends
Examples	<ul style="list-style-type: none">• Resources and relationships that provide an entity with a competitive advantage (eg an in-house research and development team in a cutting-edge technology company, or an exclusive right)• Resources and relationships that are scarce or whose continued availability is uncertain, due to factors like government intervention or climate change• Resources and relationships that create a concentration of risk (eg when the entity relies on a small number of customers or suppliers, when there is no viable alternative for a resource which is used as the main component in producing the entity's product, or when a resource can only be sourced from one or a few countries)

 Possible supporting guidance on resources and relationships is set out on slide 39

The staff's initial thinking on what the disclosure objective for external environment should cover:

Provide information and analysis to help investors and creditors understand the environment in which the entity operates and the features of the environment that affect the entity's ability to create value and generate cash flows

That includes information and analysis to help investors and creditors understand:

- factors and trends in the external environment that have affected the entity
- factors and trends in the external environment that could affect the entity's operations in the future or its ability to execute the strategy
- how effective management is in identifying and responding to changes in the entity's environment

The staff's initial thinking on what the disclosure objective for risks should cover:

Provide information and analysis to help investors and creditors understand the risks that might disrupt the direction in which the management plans to take the entity

That includes information and analysis to help investors and creditors understand:

- the risks that could affect the entity's ability to create value and generate cash flows
- the magnitude and likelihood of those risks crystallising
- how effective management is in identifying and managing those risks

The staff's initial thinking on what the disclosure objective for performance, position and progress should cover:

Provide information and analysis to help investors and creditors understand:

- **the results of the entity's operations for the reporting period**
- **how well the management has implemented its strategy**

This includes information and analysis to help investors and creditors understand:

- the extent to which the entity's financial performance and position reported in financial statements are indicative of the entity's ability to create value and generate cash flows in the future
- how the entity's results compare to management's previous expectations
- management's view of factors behind the entity's performance and position reported in financial statements and how those factors might affect the entity in the future



Appendix A
*Summary of the Board's tentative
decisions to date*

Board's tentative decisions to date (1/7)

Topic	Board decision
Making relevance and materiality judgements (July 2019)	<p>The Board tentatively decided that the revised Practice Statement should include guidance on materiality that:</p> <ul style="list-style-type: none">• incorporates key elements from IFRS Practice Statement 2 <i>Making Materiality Judgments</i>;• provides additional guidance where necessary because of the different nature of management commentary from that of financial statements;• explains the materiality process, in particular on identifying material information;• describes practical sources for identifying what matters to discuss in management commentary and material information about them;• explains how to provide a coherent narrative and highlight links between different pieces of information;• prompts management to consider the likelihood of a matter occurring and the appropriate level of aggregation in assessing what information to provide.
Faithful representation (September 2019)	<p>The Board tentatively decided that the revised Practice Statement should include guidance on the qualities that make up faithful representation based on their descriptions in the <i>Conceptual Framework</i> and explain that these qualities should be maximised to the extent possible. In particular:</p> <ul style="list-style-type: none">• guidance on completeness would explain that a complete depiction of a matter should include material information and not necessarily require management to provide <i>all</i> information it has about that matter;• guidance on neutrality would explain that:<ul style="list-style-type: none">□ each matter that needs to be discussed should be given its due prominence;□ overall tone and language used in management commentary should contribute to an unbiased depiction;□ information about a matter cannot be omitted, obscured, given undue prominence or otherwise be manipulated to influence primary users' view of that matter favourably or unfavourably;□ the likelihood of outcomes within a range of possible outcomes needs to be explained. <p>The Board highlighted the importance of using plain language in describing the qualitative characteristics of useful financial information in the revised Practice Statement.</p>

Board's tentative decisions to date (2/7)

Topic	Board decision
Enhancing qualitative characteristics (October 2019)	<p>The Board tentatively decided that the revised Practice Statement should:</p> <p>on comparability:</p> <ul style="list-style-type: none">• include a description based on the <i>Conceptual Framework</i> and explain that although comparability with other entities is desirable, it should not override the requirement to provide relevant entity-specific information;• state that management needs to consider that users need to make comparisons with information provided by other entities, by the entity in previous periods and with other information published by the entity;• require management to explain assumptions, methods of calculations and any changes (including reasons for) from the previous year, highlight where new information is provided on a matter previously reported, provide comparative information to allow emergence of trends and consider whether information is consistent with information in the financial statements and other information. <p>The Board tentatively decided that the revised Practice Statement should:</p> <p>on understandability:</p> <ul style="list-style-type: none">• include the current guidance on presentation;• explain that making management commentary concise is an important part of making it understandable;• permit the incorporation of information in management commentary by cross-reference, subject to the overarching principle that the information incorporated by cross-reference is part of management commentary and, therefore, must possess the qualitative characteristics of useful financial information. It would also include guidance on:<ul style="list-style-type: none">□ enhancing the understandability of management commentary when information is incorporated by cross-reference; and□ conditions that must be met by a report when management commentary incorporates information by cross-reference to that report.

Board's tentative decisions to date (3/7)

Topic	
Enhancing qualitative characteristics (October 2019) - <i>continued</i>	<p>The Board tentatively decided that the revised Practice Statement should:</p> <p>on verifiability:</p> <ul style="list-style-type: none">• include a description based on the <i>Conceptual Framework</i> which requires management to distinguish information based on judgement from factual information, and explain the process and sources used to produce the information, describe the assumptions and methods used to calculate it, and state the information's limitations;• retain the statement that it does not mandate the level of assurance to which management commentary should be subjected. <p>The Board decided to not include guidance on timeliness.</p>

Board's tentative decisions to date (4/7)

Topic	Board decision
Objective of management commentary (November 2018)	<p>The Board did not formally vote but broadly agreed that:</p> <ul style="list-style-type: none">the objective of management commentary should be to: <i>“give context for the financial statements by providing primary users with historical financial and operational information and analysis that is useful in assessing the prospects for the entity’s future net cash inflows, and its management’s stewardship of the entity’s economic resources”</i>;there should be guidance to support the objective. <p>In addition, the Board asked the staff to consider providing further clarity on:</p> <ul style="list-style-type: none">the roles that historical information and forward-looking information play in management commentary; andthe difference between the objective of management commentary and the objective of financial statements.
Objective of management commentary (March 2020)	<p>The Board tentatively decided that the revised Practice Statement should:</p> <ol style="list-style-type: none">retain the statement that management commentary is prepared for existing and potential investors, lenders and other creditors and refer to them as ‘primary users’; andexplain that primary users are expected to have a reasonable knowledge of business and economic activities and to review and analyse the information diligently; but such users are not expected to have knowledge of the entity to which the management commentary relates. <p>The Board also tentatively decided that the revised Practice Statement should describe the objective of management commentary as supporting primary users in assessing an entity’s prospects for future cash flows and management’s stewardship of the entity’s economic resources by providing useful information and analysis that:</p> <ol style="list-style-type: none">enhance the primary users’ understanding of the entity’s performance and position as depicted in the related financial statements; andgive insight into factors that could affect the entity’s prospects.

Board's tentative decisions to date (5/7)

Topic	Board decision
Business model (November 2019)	<p>The Board tentatively decided that the revised Practice Statement should explain the meaning of an entity's business model by reference to:</p> <ul style="list-style-type: none">(a) value that the entity creates for itself. The revised Practice Statement should also make clear that the notion of value created for an entity is related to the entity's ability to generate cash flows;(b) the link between an entity's business model and the entity's stated purpose;(c) the elements of the business model—that is its inputs, processes and outputs; and(d) a business model being a matter of fact and observable through the entity's actions. <p>The Board also tentatively decided that the revised Practice Statement should require management to discuss indirect wider consequences or impacts of the operation of the entity's business model if those impacts could affect the entity's ability to generate cash flows in the future.</p>
Business model (April 2020)	<p>The Board tentatively decided to specify in the disclosure objective for business model that:</p> <ul style="list-style-type: none">(a) management commentary should provide information and analysis to help investors and creditors understand how an entity's business model creates value and generates cash flows;(b) investors and creditors use information and analysis in management commentary make the following assessments:<ul style="list-style-type: none">i. how effective the entity's business model is in creating value and generating cash flows;ii. how scalable it is; andiii. how resilient, adaptable and durable it is;(c) the information and analysis included in management commentary should focus on the key features of an entity's business model and address:<ul style="list-style-type: none">i. the range, nature and scale of the entity's operations;ii. the entity's cycle for creating value and generating cash flows; andiii. indirect wider consequences or impacts of the entity's operations if they could affect the entity's ability to generate cash flows. <p>The Board also tentatively decided to specify that the key features of an entity's business model are those that underpin the entity's ability to create value and generate cash flows.</p>

Board's tentative decisions to date (6/7)

Topic	Board decision
Strategy (April 2020)	<p>The Board tentatively decided to specify in the disclosure objective for strategy that:</p> <ul style="list-style-type: none">(a) management commentary should provide information and analysis to help investors and creditors understand management's strategy for sustaining and developing the entity's ability to create value and generate cash flows in the future;(b) investors and creditors use information and analysis in management commentary to make the following assessments:<ul style="list-style-type: none">i. the potential effect of strategy on the entity's ability to create value and generate cash flows; andii. the entity's ability to execute the strategy;(c) the information and analysis included in management commentary should focus on the key aspects of management's strategy and address:<ul style="list-style-type: none">i. what drives the strategy;ii. what management aims to achieve in the long term;iii. how management plans to achieve those aims; andiv. how management will monitor and measure success. <p>The Board also tentatively decided to specify that the key aspects of management's strategy are those that will significantly affect an entity's ability to create value and generate cash flows in the future.</p>

Board's tentative decisions to date (7/7)

Topic	Board decision
Resources and relationships (April 2020)	<p>The Board tentatively decided to specify in the disclosure objective for resources and relationships that:</p> <ul style="list-style-type: none">(a) management commentary should provide information and analysis to help investors and creditors understand the resources and relationships on which the business model and strategy depend;(b) investors and creditors use information and analysis in management commentary to make the following assessments:<ul style="list-style-type: none">i. how much the entity depends on resources or relationships; andii. whether those resources are likely to continue to be available to the entity and whether the entity's relationships are likely to continue and strengthen;(c) the information and analysis included in management commentary should focus on the entity's key resources and relationships and address:<ul style="list-style-type: none">i. the nature of those resources and relationships;ii. how those resources and relationships are accessed;iii. how they are used;iv. what could affect the availability of the entity's resources and the strength of its relationships; andv. how those resources and relationships are managed. <p>The Board also tentatively decided to specify that an entity's key resources and relationships are those on which the entity's ability to create value and generate cash flows depend.</p>



Appendix B

Possible supporting guidance

- Slides 37–39 illustrate the staff’s initial ideas for guidance that could be included in the revised Practice Statement to help preparers meet disclosure objectives for main areas of content.
- The guidance is intended to identify the types of information and analysis that might need to be included in management commentary to meet the disclosure objectives but it is not intended to be used as a checklist or a list of minimum requirements. Management will need to exercise judgement in determining what information needs to be provided to meet the disclosure objectives.
- The staff discussed possible supporting guidance on business model, strategy and resources and relationships with the Board in April 2020, but the Board was not asked to make any decisions.

Possible supporting guidance on information and analysis about:

- The entity as a whole, including legal and operating structure and locations of operations
- Significant changes in the range, nature or scale of the entity's operations over the reporting period, including those resulting from acquisitions and disposals, strategic partnerships or joint ventures
- How the entity's business model aligns with the entity's stated purpose
- Inputs and processes, including those related to maintaining resources or developing relationships
- Outputs, including markets, customers and customer relationships, value proposition and selling and distribution channels
- Positive and negative impacts of the entity's operations that can affect the entity's ability to create value and generate cash flows, including how those impacts are monitored and managed



Associated disclosure objective and discussion of key features are provided on slides 18-19

Possible supporting guidance on information and analysis about:

- Risks, opportunities or/and purpose that inform management's strategy and underlying assumptions
- How the objectives are intended to sustain or develop the entity's ability to create value and generate cash flows over the long term
- Resource and capital allocation plans that support implementation of management's objectives
- How each plan and milestone are linked to objectives and each entity-specific time horizon being the short, medium or long-term
- Management's forecasts and targets
- Time horizons
- KPIs and how management's remuneration is linked to strategy

 Associated disclosure objective and discussion of key aspects are provided on slides 20-21

Possible supporting guidance on information and analysis about:

- The nature of resources and relationships, intangible resources and resources and relationships not recognised in the financial statements
- How resources are accessed, including whether access is direct or indirect or dependent on other resources or relationships, how the entity develops new relationships, where resources are located and information about supply chains
- How resources and relationships are used, including how much and what they are used for and how they contribute to creating value and generating cash flows
- What affects availability of resources and continuation of relationships, including the rate of depletion, expected remaining life, expected shortages and vulnerabilities
- How resources and relationships are managed, including how management monitors and measures availability and how it maintains required resources and strengthens or maintains relationships



Associated disclosure objective and discussion of key resources and relationships are provided on slides 22-23

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